

**Memorandum**

Date

From

Subject

To

MAY 7 1993

Thomas D. Roelund

Bryan B. Mitchell

Principal Deputy Inspector General

Administrative Costs Claimed Under Part B of the Health Insurance for the Aged and Disabled Program by Blue Cross and Blue Shield of Florida (A-04-92-02056)

William Toby, Jr.  
Acting Administrator  
Health Care Financing Administration

This memorandum alerts you to the issuance on May 10, 1993, of our final report. A copy is attached.

The firm of Ollie Green & Company, certified public accountants (CPA), under contract with the Office of Inspector General, conducted an audit of Medicare administrative costs incurred by Florida Blue Cross and Blue Shield, Inc. (the Plan). The Plan is the Medicare carrier for the State of Florida.

During the period October 1, 1987 through September 30, 1990, the Plan claimed costs of \$211.6 million for administering the Medicare Part B program. The audit revealed that about \$14.7 million of the costs claimed were unallowable.

The Health Care Financing Administration (HCFA) contracted with the Plan to administer the Medicare Part B program in Florida. Under the provisions of the contract, the Plan is required to receive, disburse, and account for Federal funds in making payments for services furnished to eligible Medicare beneficiaries. The Plan's responsibilities also include determining coverage of services and the reasonableness of charges, furnishing timely information and reports to HCFA, and maintaining records to ensure the correctness and verification necessary for the administration of the contract.

The Plan is entitled to reimbursement of all administrative costs claimed, provided that the provisions of the Medicare agreement have been met and that the costs were incurred in accordance with Federal regulations. The audit showed that about \$14.7 million of the costs claimed were not in accordance with Federal regulations. The unallowable claims consisted of:

Page 2 - William Toby, Jr.

- o Costs of \$11.7 million incurred and claimed in excess of budgeted amounts. The Plan exceeded the budgeted amount by \$14.7 million of which almost \$3.0 million was questionable or unallowable for other reasons. They did not seek nor did HCFA provide approval for the cost overruns.
- o Questionable costs of \$2.7 million for legal and settlement expenses as a result of a lawsuit filed by an unsuccessful bidder proposing to process Part B Medicare claims as a subcontractor for the Plan. These costs were not budgeted and prior approval was not obtained before they were incurred and paid.
- o Additional unallowable costs totaling \$0.2 million.

Also, procedural recommendations were made to the Plan.

The Plan did not agree with the majority of monetary findings in the report. They contend that they had maintained ongoing communication and dialogue with HCFA representatives, and were led to believe that supplemental funding would be released. They believe that the ongoing dialogue and subsequent budget requests met the terms of the Medicare contract. The CPA firm stated that the costs were unallowable because the Plan did not obtain the required approvals from HCFA and, therefore, the Plan was in violation of the Medicare contract which requires prior approval to exceed the budget amounts.

For further information, contact:

Emil A. Trefzger, Jr.  
Regional Inspector General  
for Audit Services, Region IV  
(404) 331-2446

Attachment

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**ADMINISTRATIVE COSTS CLAIMED  
UNDER PART B OF THE HEALTH  
INSURANCE FOR THE AGED AND  
DISABLED PROGRAM BY  
BLUE CROSS AND BLUE SHIELD  
OF FLORIDA**



MAY 1993    A-04-92-02056



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General  
Office of Audit Services

REGION IV  
P.O. BOX 2047  
ATLANTA, GEORGIA 30301

Common Identification No. A-04-92-02056

Mr. William E. Flaherty  
President  
Blue Cross and Blue Shield of Florida  
P.O. Box 60729  
Jacksonville, Florida 32236

Dear Mr. Flaherty:

We have completed our review of the report on the audit of administrative cost incurred under Medicare Part B by Blue Cross and Blue Shield of Florida (the Plan) for the period October 1, 1987 through September 30, 1990. This audit was performed by Ollie Green and Company, Certified Public Accountants. Your attention is invited to the audit findings and recommendations contained in the report.

The Plan claimed administrative costs of \$211.6 million from October 1, 1987 through September 30, 1990 on the final administrative cost proposals submitted to the Health Care Financing Administration (HCFA). The audit showed that \$14.7 million was considered unallowable because the Plan exceeded the budget limitations imposed by the contract. Included in the \$14.7 million are questionable costs for litigation settlement of \$2.7 million and costs considered unallowable for other reasons of \$233,000. The questionable litigation cost will be adjudicated by HCFA.

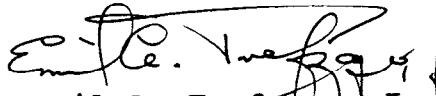
Final determinations as to the actions to be taken on all matters reported will be made by the Department of Health and Human Services action official named below. We request that you respond to each of the recommendations in this report within 30 days from the date of this letter to the action official. The Plan's comments on the CPA findings are attached to the report. Please provide the action official any additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), Office of Inspector General - Office of Audit Services reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act, which the Department chooses to exercise. (See Section 5.71 of the Department's Public Information Regulation, date August 1974, as revised.)

Page 2 - Mr. William E. Flaherty

To facilitate identification, please refer to the above common identification number in all correspondence relating to this report.

Sincerely yours,

A handwritten signature in dark ink, appearing to read "Emil A. Trefzger, Jr.", with a stylized flourish at the end.

Emil A. Trefzger, Jr.  
Regional Inspector General  
for Audit Services, Region IV

Enclosure

DHHS Action Official  
Associate Regional Administrator  
Division of Medicare  
Health Care Financing Administration  
Region IV  
101 Marietta Tower, Suite 702  
Atlanta, Georgia 30323

## SUMMARY

During the period October 1, 1987 through September 30, 1990, the Plan claimed costs of \$211.6 million for administering the Medicare Part B program. The audit revealed that about \$14.7 million of the costs claimed were unallowable.

The Health Care Financing Administration (HCFA) contracted with the Plan to administer the Medicare Part B program in Florida. Under the provisions of the contract, the Plan is required to receive, disburse and account for Federal funds in making payments for services furnished to eligible Medicare beneficiaries. The Plan's responsibilities also include the determinations as to coverage of services and the reasonableness of charges, furnishing timely information and reports to HCFA, and maintaining records to ensure the correctness and verification necessary for the administration of the contract.

The Plan is entitled to reimbursement of all administrative costs claimed, provided that the provisions of the Medicare agreement have been met and that the costs were incurred in accordance with Federal regulations. The audit showed that about \$14.7 million of the costs claimed were not in accordance with Federal regulations. The unallowable claims consisted of:

- O \$11.7 million for the costs incurred and claimed in excess of budgeted amounts. The Plan exceeded the budgeted amount by \$14.7 million of which almost \$3.0 million was questionable or unallowable for other reasons. They did not seek nor did HCFA provide approval for the cost overruns.
- O \$2.7 million for questionable costs for legal and settlement costs as a result of a law suit filed by an unsuccessful bidder proposing to process Part B Medicare claims as a subcontractor for the Plan. These costs were not budgeted and prior approval was not obtained before they were incurred and paid.
- O Additional unallowable costs totaling \$233,383.00, and other procedural recommendations were made to the Plan.

**REPORT OF EXAMINATION OF THE  
ADMINISTRATIVE COSTS INCURRED  
UNDER THE HEALTH INSURANCE FOR THE  
AGED AND DISABLED (MEDICARE)-Part B  
FOR  
BLUE CROSS AND BLUE SHIELD OF FLORIDA  
JACKSONVILLE, FLORIDA  
FOR THE PERIOD  
OCTOBER 1, 1987  
THROUGH  
SEPTEMBER 30, 1990**

**REPORT OF EXAMINATION OF THE  
ADMINISTRATIVE COSTS INCURRED  
UNDER THE HEALTH INSURANCE FOR THE AGED  
AND DISABLED (MEDICARE) - Part B**

**BLUE CROSS AND BLUE SHIELD OF FLORIDA, INC.  
JACKSONVILLE, FLORIDA**

**FOR THE PERIOD  
OCTOBER 1, 1987 THROUGH SEPTEMBER 30, 1990**

**Contract Number HHS-90-0001  
The Contract For Audit Services Was Competitively Awarded**

**Contractor: Ollie Green & Co., CPA's  
Certified Public Accountants  
Suite 100, 1018 South 4th Street, Louisville, KY 40203**

**Key Personnel: Ollie Green, Jr., MBA, CPA**

**Project Officer: Gerald Dunham  
Office of Inspector General  
Office of Audit - Region IV  
P.O. Box 1704, Atlanta, GA 30301**



Blue Cross and Blue Shield of Florida, Inc.  
Jacksonville, Florida  
October 1, 1987 Through September 30, 1990

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Blue Cross and Blue Shield of Florida, Inc.  
Jacksonville, Florida  
October 1, 1987 Through September 30, 1990

**INTRODUCTION**

**Background**

The Blue Cross and Blue Shield Association (Intermediary) has entered into an agreement with the Secretary of Health and Human Services (Secretary) to serve as an intermediary between the Secretary and providers of services under Part B of Title XVIII of the Social Security Act. Pursuant to the Plan's agreement for fiscal years ended September 30, 1988, 1989 and 1990, the Plan was responsible for administering benefit determination and payment activities for services provided to Medicare beneficiaries under Part B. See analysis below for the breakdown of claims processed and payments made during each fiscal year.

	<u>Claims Processed</u>	<u>Payments Made</u>
Fiscal Year Ended 9-30-88 Part B	28,543,804	\$2,230,581,579
Fiscal Year Ended 9-30-89 Part B	32,694,130	2,462,084,192
Fiscal Year Ended 9-30-90 Part B	36,652,687	2,941,118,711

The Plan claimed program administrative costs totaling \$57,429,189 (FY 88, Part B); \$72,162,918 (FY 89, Part B) and \$81,973,308 (FY 90, Part B).

**Scope of Audit**

Our examination consisted of a financial and compliance examination of the administrative costs incurred by the Plan, as reported on their Final Administrative Cost Proposals for the years ended September 30, 1988, 1989 and 1990. The examination was conducted in accordance with generally accepted auditing standards, and the "Standards For Audit of Governmental Organizations, Programs, Activities, and Functions." The examination field work was performed during the period July 15, 1991 through February 21, 1992 at the Plan's offices located in Jacksonville, Florida. The primary objective of the examination was to determine that the Plan's Final Administrative Cost Proposals presented fairly, in all material respects, the allowable cost of administration of the Medicare Part B Program in conformity with reimbursement principles contained in Part 31 of the Federal Acquisition Regulations, as interpreted and modified by Appendix B of the Plan's Medicare Agreements.

Additionally, we reviewed the action taken on the prior audit findings and the effectiveness of the Plan's corrective action in regard to the findings and recommendations. We reviewed and verified the accuracy of the Plan's cumulative "Interim Expenditure Reports" filed during the audit period. The tests performed were designed to determine if the Plan prepared the reports based upon verifiable statistics which resulted in accurate reporting of interim expenditures. In addition, we reviewed the Plan's methods and procedures

utilized in the preparation of the June 30, 1991 expenditure report to determine if the methods and procedures were adequately documented and would result in accurate reporting. We reviewed the Plan's compliance with complementary insurance policies and we verified the amount of credit applied to the Plan's claimed administrative costs for the years ended September 30, 1988, 1989, and 1990. Our procedures were designed to determine if the Plan was complying with complementary insurance policies and that any credit due Medicare was properly included in the "Final Administrative Cost Proposal."

Upon completion of all audit work, we prepared "draft" copies of the audit report and solicited comments from the Plan (Blue Cross and Blue Shield of Florida).

### REPORT ON REVIEW OF INTERNAL CONTROL

As part of our examination, we reviewed and tested the Plan's system of internal accounting control to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards. The purpose of our evaluation was to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on the Plan's final administrative cost proposals. Our study and evaluation was more limited than would be necessary to express an opinion on the Plan's system of internal accounting control taken as a whole.

The management of the Plan is responsible for establishing and maintaining a system of internal accounting control. The objective of internal accounting control is to provide reasonable, but not absolute, assurance that (1) assets are safeguarded against loss from unauthorized use or disposition, and (2) financial records are reliable for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a system of internal accounting controls should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

Certain inherent limitations exist that should be recognized in considering the potential effectiveness of any system of internal accounting controls. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgments, carelessness, or other personal factors. The effectiveness of some control procedures depends upon segregation of duties; these procedures can be circumvented by collusion. Similarly control procedures can be circumvented intentionally by management, either with respect to the execution and recording of transactions or with respect to the estimates and judgments required in the preparation of financial statements. Further, projection of any evaluation of internal accounting control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions and that the degree of compliance with the procedures may deteriorate. The significant elements of internal control required by Department of Health and Human Services (HHS) are:

- Accurate, current, and complete disclosure of the financial results of the Medicare program in accordance with federal reporting requirements.
- Records that adequately identify the application of funds.
- Effective control over and accountability for all funds, property, and other assets.
- Comparison of actual with budgeted amounts for each period.
- Procedures for determining the allowability and allocability of costs in accordance with FAR Part 31, and Appendix B of the Medicare agreements.
- Accounting records that are supported by source documentation.

Our study and evaluation, which included all significant areas listed above, was made for the limited purpose described in the first paragraph and would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the system of internal control of the Plan taken as a whole. However, based on our study of the significant control elements listed above, we believe that the Plan's procedures were adequate for HHS purposes except for the conditions described below, which we believe are weaknesses in relation to the agreement to which this report refers.

This report is intended solely for the purpose described above and should not be used for any other purpose.

#### Weakness

##### UNALLOWABLE COSTS CHARGED TO THE MEDICARE PROGRAM

As discussed in the Findings and Recommendations section of this report, the Plan claimed unallowable self-insurance, natural accounts, professional and consulting, common working file, legal costs and interest expense associated with leases. The Plan also exceeded budget limitations. These unallowable costs indicate that a weakness exists in the Plan's accounting system for identifying unallowable costs.

HHS requires that a system of internal control include procedures for reviewing all costs to determine whether the costs are reasonable, allocable and allowable. The failure to maintain an adequate accounting system that separates allowable and unallowable costs can result, as was the case here, in unallowable costs being claimed for reimbursement.

### Recommendation

We recommend that the Plan implement strengthened controls designed to identify and segregate costs based on reasonableness, allocability, and allowability.

### Auditee's Response

BCBSF strongly disagrees with this finding. The system and procedures BCBSF has in place are more than adequate to control, monitor, and allocate costs. Our processes have been audited by the Government since our involvement in the Medicare Program for over 26 years and during that time our process have continually met Government requirements. At this time, we are only agreeing with \$162,424 net audit findings and this represents .07% of the total budget of \$237,616,634. The other major findings cited in the audit are for reasonable, allowable, and allocable costs that would and should never be identified in any other way by our accounting system.

## REPORT ON COMPLIANCE

Generally accepted government auditing standards require financial and compliance audits to include tests of financial transactions of the audited organization, program, activity, or function to determine whether there is compliance with laws and regulations that can materially affect the entity's financial statements. In our opinion, except for the instances of noncompliance shown below, the Plan complied with the terms and provision of laws and regulations for the transactions tested.

Nothing came to our attention in connection with our examination that caused us to believe that the Plan was not in compliance with any of the terms and provision of applicable agreements, laws, and regulations for those transactions not tested.

The condition described below was considered in determining the nature, timing, and extent of the audit tests to be applied in our examination, and this condition affects our opinion on the final administrative cost proposals.

This report is intended solely for the purpose indicated above and should not be used for any other purpose.

## UNALLOWABLE EXPENSES CHARGED TO THE MEDICARE PROGRAM

As described in the Findings and Recommendations section of this report, the Plan charged unallowable self-insurance, natural accounts, professional and consulting, common working file, legal costs and interest expense associated with leases to Medicare. The Plan also exceeded budget limitations. These costs are unallowable in accordance with FAR Part 31, and Appendixes of the Medicare agreements.

## HIGHLIGHTS OF AUDIT RESULTS

Blue Cross and Blue Shield of Florida reported administrative costs totaling \$211,565,415 on its Medicare final administrative cost proposals for the period October 1, 1987 through September 30, 1990. The significant audit findings are briefly discussed below. A more detailed explanation for each significant finding appears in the findings and recommendations section of this audit report.

- 1) The Plan erroneously allocated \$101,278 of self insurance to Medicare in fiscal year 1988. This error resulted from a misapplication of the employee contribution component.
- 2) The Plan erroneously allocated \$13,263 of unallowable natural accounts costs to Medicare. These costs were inadvertently included in the final administrative cost proposal.
- 3) The Plan erroneously allocated \$18,853 of professional and consulting fees to Medicare. These cost were paid for activity not associated with Medicare.
- 4) The Plan was selected as host site for the common working file system (CWF) during fiscal year 1990; The Plan exceeded its CWF budget by \$59,451.
- 5) The Plan exceeded its NOBA by \$14,722,615 cumulatively over three fiscal periods ended September 30, 1990. These costs were incurred without prior approval.
- 6) The Plan incurred and paid \$2,731,809 in legal fees and settlement costs. These costs were allocated to Medicare without prior approval.
- 7) The Plan allocated \$40,595 in unallowable interest associated with lease expenses to Medicare. These expenses are unallowable.

## OTHER MATTERS

### Complementary Insurance Financial Policies

Our review of the Plan's complementary insurance financial policies, as discussed in the "Scope of Audit" section of this report, disclosed that the Plan received approval for its complementary insurance claims processing operations, as required by program regulations. The complementary claims operation was approved by HCFA on March 26, 1984 retroactive to October 1, 1983. We determined that the Plan is calculating and crediting Medicare in accordance with the approved proposal. Complementary insurance credits amounted to 1,561,039 for FY-88, Part B; \$2,242,585, for FY-89, Part B, and \$3,306,350 for FY-90, Part B.

### Plan's Interim Expenditure Reports

Based upon our review procedures, as discussed in the "Scope of Audit" section of this report, we determined the Plan's "Cumulative Interim Expenditure Reports" accurately reported interim administrative cost information and the Plan's methods and procedures for the preparation of the report are adequate.

### Significant EDP Expenditures

There were no significant EDP costs incurred during our audit period for planning, development or modification of the Medicare claims processing system which had not been previously approved.

## FINDINGS AND RECOMMENDATIONS

### Self-Insurance Plan

#### Findings:

The Plan allocated an excessive amount of its self-insurance cost to Medicare for fiscal year ended September 30, 1988. This error resulted from the Plan's failure to properly account for the employee contribution factor. The Plan inadvertently deducted employee contributions in arriving at the allocable gain or loss generated at year end. See required adjustment below:

Employee Contributions for fiscal year 9-30-88	\$364,047
Times Part B Medicare Percentage	<u>27.82%</u>
Adjustment Required	<u>\$101,278</u>

Far 31.201-5 states that "the applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost received by or accruing to the contractor shall be credited to the Government either as a cost reduction or by cash refund."

#### Recommendations:

We recommend that the following adjustments be made to the final administrative cost proposal (FACP):

	<u>FY-88</u>	<u>FY-89</u>	<u>FY-89</u>	<u>Total</u>
<u>Unallowable Costs:</u>	<u>\$101,278</u>	<u>-0-</u>	<u>-0-</u>	<u>\$101,278</u>

We also recommend that the Plan implement controls to insure that employee contributions paid into the self-insurance plan are properly accounted for.

### Auditee's Response

BCBSF agrees with the finding as stated above.

### Nonallowable Natural Accounts

#### Findings:

The plan claimed \$13,263 of unallowable costs from various nonallowable natural accounts. FAR section 31.201-4 states that "a cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis or relative benefits received or other equitable relationship.

"The following natural accounts were examined and determined to be unrelated to Medicare activities and, thus, unallowable:

<u>Natural Account</u>	<u>FY-88</u>	<u>FY-89</u>	<u>FY-90</u>	<u>TOTAL</u>
Advertisement	\$2,658			\$2,658
Sales Promotion	(221)			(221)
Commissions	175	\$ 20		195
Dues to Civic Business & Organizations		811		811
Ins. Dept. License Fees Blue Shield Association			\$3,356	3,356
Dues	1,491	3,253	1,689	6,433
Misc. Charitable	<u>31</u>	<u>          </u>	<u>          </u>	<u>31</u>
Totals	<u>\$4,134</u>	<u>\$4,084</u>	<u>\$5,045</u>	<u>\$13,263</u>

#### Recommendations:

We recommend that the following adjustments be made to the final administrative cost proposal (FACP).

	<u>FY-88</u>	<u>FY-89</u>	<u>FY-90</u>	<u>TOTAL</u>
<u>Unallowable Costs:</u>	<u>\$4,134</u>	<u>\$4,084</u>	<u>\$5,045</u>	<u>\$13,263</u>

We also recommend that the Plan strengthen its internal control procedures for determining allowable costs.

### Auditee's Response

BCBSF agrees with the finding as stated above.



## Professional and Consulting

### Findings:

The Plan allocated \$18,853 of unallowable professional and consulting fees to Medicare for the three fiscal years ended September 30, 1990. These costs paid to various vendors, had no Medicare relevance and thus, were not allocable to Medicare. See analysis below:

<u>Vendor</u>	<u>Cost Center</u>	<u>FY-88</u>	<u>FY-89</u>	<u>FY-90</u>	<u>Total</u>
Lewis Bailey & Assoc.	690			\$ 300	\$ 300
Lewis Bailey & Assoc.	690			101	101
TPF&C	042	\$ 1,853			1,853
TPF&C	042	496			496
TPF&C	042	1,057			1,057
TPF&C	042	1,150			1,150
Lewis Bailey & Assoc.	690	971			971
SMC Information Systems	851	2,124			2,124
TPF&C	042			2,100	2,100
TPF&C	042			2,174	2,174
TPF&C	042			530	530
Husk, Jennings & Overman	200	1,525			1,525
Husk, Jennings & Overman	200	1,086			1,086
The Martin Agency	212	508			508
TPF&C	042	2,878			2,878
Totals		<u>\$13,648</u>	<u>-0-</u>	<u>\$5,205</u>	<u>\$18,853</u>

FAR 31.201-4 states that a "cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship."

### Recommendations:

We recommend that the following adjustments be made to the final administrative cost proposal (FACP):

	<u>FY-88</u>	<u>FY-90</u>	<u>Total</u>
<u>Unallowable Costs:</u>	<u>\$13,648</u>	<u>\$5,205</u>	<u>\$18,853</u>

We also recommend that the Plan implement controls to insure that unallowable professional and consulting costs are properly screened out.

### Auditee's Response

BCBSF agrees with the finding as stated above.

## Common Working File

### Findings:

Blue Cross Blue Shield of Florida was selected as host site for the common working file system (CWF) for fiscal years 1989, 1990 and 1991. HCFA Contract Number 87-009-2 limited maximum allowable costs to \$1,520,143 for operational costs in fiscal year 1990.

Our examination revealed that the maximum allowable amount for fiscal year 1990 was exceeded. See analysis below:

	<u>Total Costs</u>	<u>NOBA Funding</u>	<u>Excess Over NOBA</u>
Fiscal Year 1990	\$1,579,594	\$1,520,143	\$59,451

As computed above, the budget was exceeded by \$59,451 in fiscal year 1990. These costs are unallowable in accordance with Article XVI, (Cost Of Administration) paragraphs C, H and I of the Part B Medicare agreement.

### Recommendations:

We recommend that the following adjustments be made to the final administrative cost proposal (FACP).

	<u>FY-89</u>	<u>FY-90</u>	<u>Total</u>
Unallowable costs:	\$ -0-	\$59,451	\$59,451

We also recommend that the Plan implement controls to monitor NOBA limitations prior to allocating costs to Medicare.

### Auditee's Response

The NOBA funding amount (\$1,520,143) used by the Audit firm to determine the finding is understated by \$57. Therefore, BCBSF has restated the dollar amount based on the approved NOBA funding of \$1,520,200. The restated dollar amount of the finding is:

Medicare A:			
Medicare B:	\$	\$59,394	\$59,394

BCBSF disagrees with this finding. BCBSF did exceed the budget for the contract period noted. However, BCBSF contends that these costs were allowable in that they were incurred to perform BCBSF's contractual obligations under its cost reimbursed contract. Article XVI, paragraph G states "...if costs in excess of the indicated amount are in fact incurred by the Carrier, its right to claim such costs under paragraph I will not be prejudiced thereby."

## Excess FACP Costs Over NOBA Limitation

### Findings:

During fiscal year 1989, the Plan selected a new subcontractor to process its Medicare Part B claims. The implementation component of this action was very complicated and problematic. The Plan accumulated a substantial amount of overtime and various other costs in making the transition from the old to the new system. These costs were examined and found to be "otherwise" allowable had they not exceeded NOBA limitations. See analysis below:

	<u>FY-88</u>	<u>FY-89</u>	<u>FY-90</u>	<u>Total</u>
Costs per FACP	\$57,429,189	\$72,162,918	\$81,973,308	\$211,565,415
Cost per NOBA	<u>57,130,800</u>	<u>67,156,200</u>	<u>72,555,800</u>	<u>196,842,800</u>
Excess FACP costs	<u>\$ 298,389</u>	<u>\$ 5,006,718</u>	<u>\$ 9,417,508</u>	<u>\$ 14,722,615</u>

These costs are unallowable in accordance with Article XVI, (Cost Of Administration) paragraphs C, H and I of the Part B Medicare agreement.

### Recommendations:

We recommend that the following adjustments be made to the final administrative cost proposal (FACP):

	<u>FY-88</u>	<u>FY-89</u>	<u>FY-90</u>	<u>Total</u>
Unallowable costs:	<u>\$ 298,389</u>	<u>\$ 5,006,718</u>	<u>\$ 9,417,508</u>	<u>\$ 14,722,615</u>

We also recommend that systems be implemented to monitor NOBA limitations prior to allocating costs to Medicare.

Note: These unallowable costs include \$2,731,809 of questionable legal fees and settlement costs included on page 11 of this report under the caption "Litigation and Settlement Costs".

### Auditee's Response

BCBSF strongly disagrees with the finding. During FY 1988, BCBSF incurred significant costs associated with the GTE implementation effort. In FY 1989, BCBSF implemented the GTE system. This effort was a major system conversion and required additional resources first, to support the implementation effort, and then, upon implementation, to reduce the inventory levels and maintain adequate service levels. It is important to note that Mr. Green found these costs to be "otherwise allowable" had they not exceeded NOBA limitations.

The recommendations that these costs be disallowed is based upon BCBSF's alleged failure to abide by Article XVI, paragraphs C, H and I of the Part B Medicare Agreement. During the audit period, BCBSF continually maintained ongoing communication with HCFA related to its projected annual funding needs through filing monthly Interim Expenditure Reports, Monthly Plan of Expenditure Reports, Quarterly Variance Reports and numerous Requests for Supplemental Funding. Through ongoing dialogue with HCFA representatives, as required by paragraph H of the Medicare Part B Agreement, and BCBSF's past experience with the HCFA NOBA process, <sup>1</sup> BCBSF was led to believe that supplemental funding would be released. BCBSF contends that the ongoing dialogue and subsequent budget requests met the terms of Article XVI, paragraphs C, H and I of the Medicare contract. At no time during the audit period did HCFA instruct BCBSF to reduce its level of work activity. Due to BCBSF's concerted effort to keep HCFA abreast of its funding requirements for both fiscal years and the fact that BCBSF incurred these otherwise allowable costs in good faith and in order to achieve the implementation of the new system, BCBSF contends that the costs were legitimate and should be reimbursed.

#### Litigation and Settlement Costs

##### Findings:

The Plan paid \$2,731,809 in legal fees and settlement costs as a result of a law suit filed by MDC. MDC was unsuccessful as a bidder proposing to process part-B Medicare claims as a subcontractor for the Plan. The suit was litigated and settled out of court and the Plan paid MDC \$1,045,000 by August 31, 1990. These costs were not budgeted and prior approval was not obtained before they were incurred and paid.

The Plan has requested HCFA's legal counsel to review the aforementioned costs and rule on whether these costs are reasonable, allowable and allocable to Medicare. As of the issuance date of this report (February 21, 1992), HCFA had not issued its ruling on how these costs should be handled. All costs associated with this law suit were accumulated in cost center 365 and broke down as follows:

Legal Fees and Miscellaneous Charges	\$1,686,809
Settlement Costs	<u>1,045,000</u>
Total	<u>\$2,731,809</u>

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<sup>1</sup> Indeed, in the five fiscal years immediately preceding the audit period, BCBSF followed the same procedures as outlined above and ultimately received NOBA funding. We understand that it is common practice for carriers to operate without NOBA funding and that this practice is part of the normal HCFA/Carrier relationship.

Article XV of the agreement states that "In the event the Carrier or any of its directors, officers, or employees or other persons who are engaged or retained by the Carrier to participate directly in the claims administration process, are made parties to any judicial or administrative proceeding arising, in whole or in part, out of any function of the Carrier under this contract, the amounts of any judgements, awards, costs, expenses, or other expenditures directly or indirectly incurred by the Carrier or any of its directors, officers, or employees, or by other persons who are engaged or retained by the Carrier to participate directly in the claims administration process, in connection with such proceedings, shall be reimbursable, to the extent permitted by law, unless the liability underlying the judgement or award was the direct consequence of conduct on the part of the Carrier determined by judicial proceedings or the agency making the award to be criminal in nature, fraudulent, or grossly negligent. Administrative costs which are incurred in connection with any settlement of any proceeding described in the previous sentence of this paragraph shall only be reimbursable if such settlement was entered into with the prior written approval of the Secretary."

#### Recommendations:

We recommend that these costs remain in questionable cost status until HCFA has made its ruling on the allowability and allocability of these costs.

	<u>FY-90</u>	<u>Total</u>
<u>Questionable Costs:</u>	<u>\$2,731,809</u>	<u>\$2,731,809</u>

#### Auditee's Response

BCBSF is entitled to legal fees and expenses in the MDC litigation in the amount of \$1,686,809 as a matter of right, in accordance with Article XV, paragraph E of the Medicare Part B Agreement. These allowable costs arose out of MDC's challenge of BCBSF's selection of its Medicare Part B data facilities management subcontractor and HCFA's procurement policies. These matters clearly arose out of BCBSF's functions as a Medicare Carrier. Under paragraph E, costs which arose "...in whole or in part, out of any function of the Carrier under the (Medicare Part B) contract, the amounts of any...expenses, or other expenditure directly or indirectly incurred by the Carrier...shall be reimbursable, to the extent permitted by law, unless the liability underlying the judgement or award was the direct consequences of conduct on the part of the Carrier determined by judicial proceedings or the agency making the award to be criminal in nature, fraudulent, or grossly negligent." There was no judicial or administrative finding of such wrongdoing on the part of BCBSF in the MDC litigation. See Exhibit A (attached). To the contrary, HCFA specifically found, as a request of its independent investigation (which resulted from a complaint by MDC) that there was no wrongdoing on the part of the Carrier. Further, there is no requirement that these costs receive the prior approval of the Secretary. Under paragraph E, only settlement costs (not other expenses of litigation such as attorneys fees and court costs) require prior approval of the Secretary.

Accordingly, BCBSF is entitled to immediate and full reimbursement of allowable litigation costs in the amount of \$1,686,809.

Additionally, BCBSF believes that its settlement costs in the MDC litigation in the amount of \$1,045,000 should be fully reimbursed as a matter of fairness and equity. The litigation was settled on highly favorable terms to BCBSF and HCFA. While the nature of the settlement negotiations did not provide an opportunity for obtaining the secretary's prior written approval of the settlement costs, immediately following settlement, BCBSF officials met with senior HCFA officials to discuss the settlement and to request HCFA's full reimbursement. During this meeting and in subsequent correspondence with HCFA, BCBSF fully explained the settlement and the reasons for its request for full reimbursement. These reasons, most notably the fact that HCFA obtained a full release from MDC in connection with the settlement, are fully described in an August 21, 1990 letter from Mr. Bruce A. Davidson, General Counsel of BCBSF at the time, to Ms. Gagel of HCFA, a copy of which is attached hereto as Exhibit B.

Importantly, Mr. Green's audit recommendation is not to disallow these otherwise allowable costs but to defer to HCFA's decision on this matter. Given the benefits to HCFA and the Medicare program resulting from BCBSF's selection of GTE and the settlement of the MDC litigation, BCBSF respectfully submits that the appropriate decision is full reimbursement of BCBSF for these costs. BCBSF requests the support of Mr. Green in urging HCFA to make such recommendation.

#### Auditor's Additional Comments:

As indicated in Article XV above, these costs are reimbursable unless the liability underlying the judgement or award was the direct consequence of conduct on the part of the carrier determined by judicial proceedings or the agency making the award to be criminal in nature, fraudulent or grossly negligent. We feel that once HCFA had made its determination as to whether the carrier was criminal, fraudulent or grossly negligent, then the applicability of Article XV can be more clearly determined. Until this happens, we recommend that these costs remain in questionable status as we previously indicated.

#### Unallowable Interest Expenses Associated With "Operational Leases" Findings:

The Plan allocated \$40,595 in unallowable interest associated with "operational leases" to Medicare. For fiscal year 1990 this error resulted from the Plan's failure to eliminate the interest factor from operational leases where the total lease payments were substantially in excess of the purchase price. See calculation below:

Meridian Leasing Company  
100% Allocated to Part-B, Medicare

Total lease payments (20,520 x 60)	\$1,231,200
Price, If Purchased	<u>1,009,774</u>
Difference (Interest)	<u>\$ 221,426</u>

Monthly Allocation to Medicare

$$\frac{\text{Total Interest Factor Calculated Above} = \$221,426}{\text{Lease Period} \quad \quad \quad 60 \text{ Months}} = \$3,690$$

$$\$3,690.43 \text{ interest per month} \times 11 \text{ months (11-89 through 9-90)} = \$40,595$$

As indicated above the Meridian Leasing Company lease was allocated to Medicare at 100%. This lease became effective in November of 1989 and ran through the end of the audit period, September, 1990, (eleven months).

Our approach in determining the amount of interest expense allocated to Medicare entailed using a straight line calculation (total interest divided by lease period times Medicare months). We used this approach because all information required to run an amortization schedule was not available.

Far Section 31.205-36 specifically disallows any interest associated with any lease allocated as administrative costs to the medicare program.

Recommendations:

We recommend that the following adjustments be made to the final administrative cost proposal (FACP):

	<u>FY 90</u>	<u>Total</u>
<u>Unallowable Costs:</u>	<u>\$40,595</u>	<u>\$40,595</u>

We also recommend that the Plan implement a system to insure that interest expense related to leases is not allocated to Medicare.

Auditee's Response

BCBSF disagrees with this finding. The finding references FAR Section 31.205-36 as specifically disallowing interest expense associated with an operating lease. We find no language in this FAR that states this. Additionally this FAR states Section 31.205-36 does not apply to ADPE and references FAR section 31.205-2. FAR 31.205-36 part 1 does state rental costs under operating leases are allowable to the extent that the rates are reasonable at the time of the lease decision.

The decision to lease or purchase computer equipment (DASD Device) for CWF was analyzed by the Blue Cross Technical Services area. The analysis considered the present value of all related cash flows including monthly lease payments, tax considerations, and cash purchase price. The analysis showed the present value of the purchase to be \$890,373, excluding return on investment of \$56,000 for the first year versus the present value of lease payments to be \$822,890, resulting in a decision to lease.

This financial decision was not the only factor considered as part of this analysis although it certainly is important. The risk involved with a purchase of this magnitude and the dynamic nature of technology must also be considered in such a decision. Data processing equipment is constantly changing and may become obsolete. BCBSF was awarded a three year contract for CWF. Purchase of this EDP equipment would have locked CWF with the current technology and could have exposed the government (HCFA) to excessive financial loss due to the equipment becoming obsolete. Leasing the equipment provides for economical disposal in the event the contract is terminated and could provide for an economical upgrade of equipment based on need. Of the choices available to BCBSF in acquiring this equipment, we selected the one that was most advantageous to the Government.

All factors considered at the time indicate leasing as the best course of action.

#### Auditor's Additional Comments

The question here is not whether the plan made the right decision to lease or purchase but whether there is an unallowable cost (interest) included in the amounts charged to Medicare. FAR 31.205-36 (Rental costs) does not specifically address the disallowance of interest for ADPE but references 31.205-2 (Automatic data processing equipment leasing costs). FAR 31.205-2(b)(1) states that "if the contractor leases ADPE but cannot demonstrate, on the basis of facts existent at the time of the decision to lease or continue leasing and documented, in accordance with paragraph (d), (Supporting data for leasing decisions) that leasing will result in less cost to the government over the estimated useful life, then rental costs are allowable only up to the amount that would be allowed had the contractor purchased the ADPE." The plan did not demonstrate to us that the cost of leasing this equipment over its estimated useful life would result in less cost to the government at the time of our examination. FAR 31.205-2(2) states that "technological advances will not justify replacing existing ADPE before the end of its physical life if it will be able to satisfy future requirements or demands." Thus, technological advance is not justification for equipment replacement if the equipment will still get the job done! FAR 31.205-2(3) further states that "in estimating the least cost to the government for useful life, the cumulative costs that would be allowed if the contractor owned the ADPE should be compared with cumulative costs that would be allowed under any of the various types of leasing arrangements available. For the purpose of this comparison, the costs of ADPE exclude "interest or other unallowable costs." We maintain our initial position on this issue.



# OLLIE GREEN & COMPANY

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(502) 585-3187

Ollie Green Jr., CPA  
Jane A. Lapinski, CPA

## INDEPENDENT AUDITOR'S REPORT

We have examined the administrative costs incurred, as reported on the "Final Administrative Cost Proposals," of Blue Cross and Blue Shield of Florida, Inc., for the years ended September 30, 1988, 1989 and 1990. Our examination was made in accordance with generally accepted auditing standards and the "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions." Accordingly, the examination included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. Additionally, our audit procedures included, but were not limited to, the Department of Health and Human Services, Interim Audit Instruction E-1, Revised Part I, which we used as a guide for our examination.

In our opinion, except for adjustments set out in the "Findings and Recommendations" section of this report, the Final Administrative Cost Proposals of Blue Cross and Blue Shield of Florida, Inc. for the years ended September 30, 1988, 1989, and 1990 present fairly the administrative costs incurred under Title XVIII of the Social Security Act (Medicare - Part B) in conformity with the reimbursement principles contained in Part 31 of the Federal Acquisition Regulations, as interpreted and modified by Appendix B of the Plan's Medicare Agreement.



Ollie Green & Co., CPA's  
Certified Public Accountants

Louisville, Kentucky  
February 21, 1992

## FINANCIAL STATEMENTS

**Blue Cross and Blue Shield of Florida**  
**Final Administrative Cost Proposal**  
**For the Period October 1, 1987 Through September 30, 1988**

**FY-88 Part B**

<u>Operation</u>	<u>Administrative Costs Claimed</u>	<u>Recommended Adjustments</u>	<u>Footnote Reference</u>
Claims Payment	\$27,985,321	\$ 0	
Reviews & Hearings	3,327,217	0	
Medical Review & Utilization Review	6,302,206	0	
Beneficiary/Phys. Inquiry	13,013,002	0	
Productivity Investments	2,556,523	0	
Medicare Secondary Payer	1,992,489	0	
Physician Fee Freeze	1,889,331	0	
Other	363,100	0	
Unallowable Costs	0	417,449	P. 22 - 23
 Total	 <u>\$57,429,189</u>	 <u>\$ 417,449</u>	

Blue Cross and Blue Shield of Florida  
 Final Administrative Cost Proposal  
 For the Period October 1, 1988 Through September 30, 1989

FY-89 Part B

<u>Operation</u>	<u>Administrative Costs Claimed</u>	<u>Recommended Adjustments</u>	<u>Footnote Reference</u>
Claims Payment	\$41,561,798	\$ 0	
Reviews & Hearings	4,049,437	0	
Medical Review & Utilization Review	6,227,640	0	
Beneficiary/Phys. Inquiry	12,078,166	0	
Printing Claims Forms	369,641	0	
Physician Fee Freeze	1,835,372	0	
Productivity Investments	3,501,894	0	
Medicare Secondary Payer	2,251,770	0	
Other	287,200		
Unallowable Costs		5,010,802	P. 22 - 23
Total	<u>\$72,162,918</u>	<u>\$5,010,802</u>	

Blue Cross and Blue Shield of Florida  
Final Administrative Cost Proposal  
For the Period October 1, 1989 Through September 30, 1990

FY-90 Part B

<u>Operation</u>	<u>Administrative Costs Claimed</u>	<u>Recommended Adjustments</u>	<u>Footnote Reference</u>
Claims Payment	\$42,865,385	\$ 0	
Beneficiary/Phys. Inquiry	12,331,081	0	
Reviews & Hearings	8,647,001	0	
Medical Review & Utilization Review	7,835,333	0	
Printing Claims Forms	509,532	0	
Physician Fee Freeze	1,968,305	0	
Productivity Investments	4,840,884	0	
Medicare Secondary Payer	2,458,987	0	
Other	4,000	0	
Other	512,800		
Unallowable Costs		12,259,756	P. 22 - 23
Total	<u>\$81,973,308</u>	<u>\$12,259,756</u>	

# Blue Cross Blue Shield of Florida

## Footnotes

10-01-87 through 09-30-90

<u>Note Recommended</u> <u>No. Adjustments</u>	<u>FY - 88</u>	<u>FY - 89</u>	<u>FY - 90</u>	<u>Total</u>
1 Recommended adjustment for unallowable Self-Insurance. See page 7 for details	\$101,278	-0-	-0-	\$ 101,278
2 Recommended adjustment for unallowable natural account allocation. See pages 7-8 for details	4,134	4,084	5,045	13,263
3 Recommended adjustment for unallowable professional and consulting. See pages 8-9 for details	13,648	-0-	5,205	18,853
4 Recommended adjustment for unallowable CWF costs claimed in excess of budget. See pages 9-10 for details	-0-	-0-	59,451	59,594
5 Recommended adjustment for cost in excess of budget. See pages 11-12 for details	298,389	5,006,718	9,417,508	14,722,615
6 Recommended adjustment for questionable litigation and settlement costs. See pages 12-14 for details	-0-	-0-	2,731,809	2,731,809

*\$143<sup>00</sup> difference*

# Blue Cross Blue Shield of Florida

## Footnotes

10-01-87 through 09-30-90

<u>Note Recommended</u> <u>No. Adjustments</u>	<u>FY - 88</u>	<u>FY - 89</u>	<u>FY - 90</u>	<u>Total</u>
7 Recommended adjustment for unallowable interest expense associated with leases. See pages 14-16 for details.	<u>-0-</u>	<u>-0-</u>	<u>40,595</u>	<u>40,595</u>
TOTALS	<u>\$417,449</u>	<u>\$5,010,802</u>	<u>\$12,259,613</u>	<u>\$17,687,864</u> <del><u>\$17,688,007</u></del>

FLORIDA BLUE CROSS BLUE SHIELD

COMMENTS ON AUDIT FINDINGS

Note: These comments have been summarized  
in the audit report. This document  
is a complete text of their comments.



MEDICARE AUDIT  
SUMMARY OF FINDINGS AND PLAN RESPONSE  
FISCAL YEARS 1988 - 1990

I. OVERVIEW OF ADMINISTRATIVE FUNDS DRAWN

Ollie Green and Co., Inc. cited findings in the draft audit report of \$14,925,634. Blue Cross and Blue Shield of Florida (BCBSF) has provided responses to each of the individual findings, however, it should be noted that BCBSF has not been reimbursed for actual filed costs (reference E below) and in some instances BCBSF has not been reimbursed the total budget allotment for a given fiscal year (reference D below). A comparison of actual administrative funds drawn, notice of budget approvals (NOBA), and costs filed on the final administrative cost proposal (FACP) is shown below:

	<u>FY'88</u>	<u>FY'89</u>	<u>FY'90</u>
<u>Medicare A:</u>			
A. NOBA	\$11,655,934	\$13,015,600	\$16,114,500
B. Costs per FACP	11,635,709	12,676,676	16,114,428
C. Administrative Funds Drawn	<u>11,635,709</u>	<u>12,676,676</u>	<u>15,889,500</u>
D. Difference (A - C)	20,225	38,924	225,000
E. Difference (B - C)	\$ 0	\$ 0	\$ 224,928

For Medicare Part A. BCBSF did not draw funds in FY 1990 to cover total filed costs. Therefore, the Plan is immediately entitled to \$225,000 from HCFA, excluding any audit findings.

	<u>FY'88</u>	<u>FY'89</u>	<u>FY'90</u>
<u>Medicare B:</u>			
A. NOBA	\$57,130,800	\$67,156,200	\$72,555,800
B. Costs per FACP	57,429,189	72,162,918	81,973,308
C. Administrative Funds	<u>57,118,600</u>	<u>67,156,200</u>	<u>72,017,600</u>
D. Difference (A - C)	12,200	0	538,200
E. Difference (B - C)	\$ 298,389	\$ 5,006,718	\$ 9,955,708

Based upon the above chart BCBSF Medicare Part B did not draw funds to cover the filed cost for all three years and additionally, we did not draw to the NOBA level for fiscal years 1988 and 1990. Therefore, excluding any audit findings, BCBSF is immediately due \$ 550,400 from the HCFA for Fiscal Years 1988 and 1990.

## II. REPORT ON REVIEW OF INTERNAL CONTROL

**SUMMARY OF FINDING:** Audit: "As discussed in the Findings and Recommendations section of this report, the Plan claimed unallowable self-insurance, natural accounts, professional and consulting, common working file, legal costs and interest expense associated with leases. The Plan also exceeded budget limitations. These unallowable costs indicate that a weakness exists in the Plan's accounting system for identifying unallowable costs.

HHS requires that a system of internal control include procedures for reviewing all costs to determine whether the costs are reasonable, allocable and allowable. The failure to maintain an adequate accounting system that separates allowable and unallowable costs can result, as was the case here, in unallowable costs being claimed for reimbursement.

We recommend that the Plan implement strengthened controls designed to identify and segregate costs based on reasonableness, allocability and allowability."

**RESPONSE TO FINDING:** BCBSF strongly disagrees with this finding. The system and procedures BCBSF has in place are more than adequate to control, monitor, and allocate costs. Our processes have been audited by the Government since our involvement in the Medicare Program for over 26 years and during that time our processes have continually met Government requirements. At this time, we are only agreeing with \$162,424 of net audit findings and this represents .07% of the total budget of \$237,616,634. The other major findings cited in the audit are for reasonable, allowable, and allocable costs that would and should never be identified in any other way by our accounting system.

## III. FINDINGS AND RECOMMENDATIONS

### 1. SELF INSURANCE PLAN

**SUMMARY OF FINDING:** "The Plan allocated an excessive amount of its self-insurance cost to Medicare for the fiscal year ending September 30, 1988. This error resulted from the Plan's failure to properly account for the employee contribution factor. The Plan inadvertently deducted employee contributions in arriving at the allocable gain or loss generated at year end...."

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Dollar amounts of the finding are:

	<u>FY'88</u>	<u>FY'89</u>	<u>FY'90</u>	<u>TOTAL</u>
Medicare A:	\$ 22,571			\$ 22,571
Medicare B:	101,278			\$101,278

RESPONSE TO FINDING: BCBSF agrees with the finding as stated above.

2. NON-ALLOWABLE NATURAL ACCOUNTS

SUMMARY OF FINDING: "The Plan claimed unallowable costs from various non-allowable natural accounts. FAR section 31.201-4 states that 'a cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship.'"

Dollar amounts of the finding are:

Medicare A:

	<u>FY'88</u>	<u>FY'89</u>	<u>FY'90</u>	<u>TOTAL</u>
Advertisement	\$1,843			\$1,843
Sales Promotion	51	\$(59)		(8)
Commissions	14		\$ 38	52
Dues to Civic Business & Organizations	93	158		251
Scholarship Fund		608		608
Ins. Dept. License Fees			830	830
Total	<u>\$2,001</u>	<u>\$707</u>	<u>\$868</u>	<u>\$3,576</u>

Medicare B:

	<u>FY'88</u>	<u>FY'89</u>	<u>FY'90</u>	<u>TOTAL</u>
Advertisement	\$2,658			\$2,658
Sales Promotion	(221)			(221)
Commissions	175	20		195
Dues to Civic Business & Organizations		811		811
Ins. Dept. License Fees			\$3,356	3,356
Blue Shield Association				
Dues	1,491	3,253	1,689	6,433
Misc. Charitable	31			31
Total	<u>\$4,134</u>	<u>\$4,084</u>	<u>\$5,045</u>	<u>\$13,263</u>

RESPONSE TO FINDING: BCBSF agrees with the finding as stated

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above.

3. PROFESSIONAL AND CONSULTING

SUMMARY OF FINDING: "The Plan allocated unallowable professional and consulting fees to Medicare for the three fiscal years ended September 30, 1990. These costs had no Medicare relevance and thus, were not allocable to Medicare."

Dollar amounts of the finding are:

<u>Medicare A:</u>	<u>FY'88</u>	<u>FY'89</u>	<u>FY'90</u>	<u>Total</u>
Lewis Bailey & Assoc.			\$ 24	
Lewis Bailey & Assoc.			8	78
TPF&C	\$361			361
TPF&C	97			97
TPF&C	206			206
TPF&C	224			224
Lewis Bailey & Assoc.	47			47
SMC Information Systems	50			50
TPF&C			311	311
TPF&C			322	322
TPF&C			79	79
Husk, Jennings & Overman	297			297
Husk, Jennings & Overman	211			211
The Martin Agency	85			85
TPF&C	561			561
Totals	<u>\$2,139</u>	<u>0</u>	<u>\$744</u>	<u>\$2,883</u>

<u>Medicare B:</u>	<u>FY'88</u>	<u>FY'89</u>	<u>FY'90</u>	<u>Total</u>
Lewis Bailey & Assoc.			\$300	\$ 300
Lewis Bailey & Assoc.			101	101
TPF&C	\$1,853			1,853
TPF&C	496			496
TPF&C	1,057			1,057
TPF&C	1,150			1,150
Lewis Bailey & Assoc.	971			971
SMC Information Systems	2,124			2,124
TPF&C	2,100		2,100	
TPF&C	2,174		2,174	
TPF&C			530	530
Husk, Jennings & Overman	1,525			1,525
Husk, Jennings & Overman	1,086			1,086
The Martin Agency	508			508
TPF&C	2,878			2,878
Total	<u>\$13,648</u>	<u>0</u>	<u>\$5,205</u>	<u>\$18,853</u>

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RESPONSE TO FINDING: BCBSF agrees with the finding as stated above.

4. COMMON WORKING FILE

SUMMARY OF FINDING: "Blue Cross and Blue Shield of Florida was selected as host site for the common working file system (CWF) for fiscal years 1989, 1990 and 1991. HCFA Contract Number 87-009-2 limited maximum allowable costs to \$1,520,143 for operational costs in fiscal year 1990. BCBSF exceeded the budget for fiscal year 1990...These costs are unallowable in accordance with Article XVI, (Cost of Administration) paragraphs C, H and I of the Part B Medicare agreement."

Dollar amounts of the finding are:

	<u>FY '88</u>	<u>FY '89</u>	<u>FY '90</u>	<u>Total</u>
Medicare A:	\$			
Medicare B	\$		\$ 59,451	\$59,451

RESPONSE TO FINDING: The NOBA funding amount (\$1,520,143) used by the Audit firm to determine the finding is understated by \$57. Therefore, BCBSF has restated the dollar amount based on the approved NOBA funding of \$1,520,200. The restated dollar amount of the finding is:

Medicare A:	\$			
Medicare B	\$		\$ 59,394	\$59,394

BCBSF disagrees with this finding. BCBSF did exceed the budget for the contract period noted. However, BCBSF contends that these costs were allowable in that they were incurred to perform BCBSF's contractual obligations under its cost reimbursed contract. Article XVI, paragraph G states "...if costs in excess of the indicated amount are in fact incurred by the Carrier, its right to claim such costs under paragraph I will not be prejudiced thereby."

5. EXCESS FACP COSTS OVER NOBA LIMITATION

SUMMARY OF FINDING: "During FY 1989 the Plan selected a new subcontractor to process its Medicare Part B claims. The implementation component of this action was very complicated and problematic and resulted in increased costs in making the transition from the old to the new system. These costs were examined and found to be "otherwise" allowable had they not exceeded NOBA limitations. These costs are unallowable in accordance with Article XVI, (Cost of Administration) paragraphs C, H and I of the Part B Medicare agreement...."

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Dollar amounts of the finding are:

	<u>FY '88</u>	<u>FY '89</u>	<u>FY '90*</u>	<u>Total</u>
Medicare B:				
Costs per FACP	\$57,429,189	\$72,162,918	\$81,973,308	\$211,565,415
Costs per NOBA	<u>57,130,800</u>	<u>67,156,200</u>	<u>72,555,800</u>	<u>196,842,800</u>
Excess FACP costs	<u>\$ 298,389</u>	<u>\$ 5,006,718</u>	<u>\$ 9,417,508</u>	<u>\$ 14,722,615</u>

\*These unallowable costs include \$2,731,809 of questionable legal fees and settlement costs which are addressed under "Litigation and Settlement Costs".

**RESPONSE TO FINDING:** BCBSF strongly disagrees with the finding. During FY 1988, BCBSF incurred significant costs associated with the GTE implementation effort. In FY 1989, BCBSF implemented the GTE system. This effort was a major system conversion and required additional resources first, to support the implementation effort, and then, upon implementation, to reduce the inventory levels and maintain adequate service levels. It is important to note that Mr. Green found these costs to be "otherwise allowable" had they not exceeded NOBA limitations.

The recommendations that these costs be disallowed is based upon BCBSF's alleged failure to abide by Article XVI, paragraphs C, H and I of the Part B Medicare Agreement. During the audit period, BCBSF continually maintained ongoing communication with HCFA related to its projected annual funding needs through filing monthly Interim Expenditure Reports, Monthly Plan of Expenditure Reports, Quarterly Variance Reports and numerous Requests for Supplemental Funding. Through ongoing dialogue with HCFA representatives, as required by paragraph H of the Medicare Part B Agreement, and BCBSF's past experience with the HCFA NOBA process, BCBSF was led to believe that supplemental funding would be released. BCBSF contends that the ongoing dialogue and subsequent budget requests met the terms of Article XVI, paragraphs C, H and I of the Medicare contract. At no time during the audit period did HCFA instruct BCBSF to reduce its level of work activity. Due to BCBSF's concerted effort to keep HCFA abreast of its funding requirements for both fiscal years and the fact that BCBSF incurred these otherwise allowable costs in good faith and in order to

Indeed, in the five fiscal years immediately preceding the audit period, BCBSF followed the same procedures as outlined above and ultimately received NOBA funding. We understand that it is common practice for carriers to operate without NOBA funding and that this practice is part of the normal HCFA/Carrier relationship.

achieve the implementation of the new system, BCBSF contends that the costs were legitimate and should be reimbursed.

6. LITIGATION AND SETTLEMENT COSTS

SUMMARY OF FINDING: "The Plan paid \$2,731,809 in legal fees and settlement costs as a result of a lawsuit filed by MDC. These costs were not budgeted and prior approval was not obtained before they were incurred and paid."

Dollar amounts of the finding are:

	<u>FY'88</u>	<u>FY'89</u>	<u>FY'90</u>	<u>TOTAL</u>
Medicare B:			2,731,809	2,731,809

RESPONSE TO FINDING: BCBSF is entitled to legal fees and expenses in the MDC litigation in the amount of \$1,686,809 as a matter of right, in accordance with Article XV, paragraph E of the Medicare Part B Agreement. These allowable costs arose out of MDC's challenge of BCBSF's selection of its Medicare Part B data facilities management subcontractor and HCFA's procurement policies. These matters clearly arose out of BCBSF's functions as a Medicare Carrier. Under paragraph E, costs which arose "...in whole or in part, out of any function of the Carrier under the (Medicare Part B) contract, the amounts of any...expenses, or other expenditure directly or indirectly incurred by the Carrier...shall be reimbursable, to the extent permitted by law, unless the liability underlying the judgement or award was the direct consequence of conduct on the part of the Carrier determined by judicial proceedings or the agency making the award to be criminal in nature, fraudulent, or grossly negligent." There was no judicial or administrative finding of such wrongdoing on the part of BCBSF in the MDC litigation. See Exhibit A (attached). To the contrary, HCFA specifically found, as a result of its independent investigation (which resulted from a complaint by MDC) that there was no wrongdoing on the part of the Carrier. Further, there is no requirement that these costs receive the prior approval of the Secretary. Under paragraph E, only settlement costs (not other expenses of litigation such as attorneys fees and court costs) require prior approval of the Secretary. Accordingly, BCBSF is entitled to immediate and full reimbursement of allowable litigation costs in the amount of \$1,686,809.

Additionally, BCBSF believes that its settlement costs in the MDC litigation in the amount of \$1,045,000 should be fully reimbursed as a matter of fairness and equity. The litigation was settled on highly favorable terms to BCBSF and HCFA. While the nature of the settlement negotiations did not provide an opportunity for obtaining the secretary's prior written approval of the settlement costs, immediately following settlement, BCBSF officials met with senior HCFA officials to discuss the settlement and to request HCFA's full reimbursement. During this meeting and in subsequent

correspondence with HCFA, BCBSF fully explained the settlement and the reasons for its request for full reimbursement. These reasons, most notably the fact that HCFA obtained a full release from MDC in connection with the settlement, are fully described in an August 21, 1990 letter from Mr. Bruce A. Davidson, General Counsel of BCBSF at the time, to Ms. Gagel of HCFA, a copy of which is attached hereto as Exhibit B.

Importantly, Mr. Green's audit recommendation is not to disallow these otherwise allowable costs but to defer to HCFA's decision on this matter. Given the benefits to HCFA and the Medicare program resulting from BCBSF's selection of GTE and the settlement of the MDC litigation, BCBSF respectfully submits that the appropriate decision is full reimbursement of BCBSF for these costs. BCBSF requests the support of Mr. Green in urging HCFA to make such recommendation.

7. INTEREST EXPENSE ASSOCIATED WITH OPERATIONAL LEASES

SUMMARY OF FINDING: "The Plan allocated \$40,595 in unallowable interest associated with "operational leases" to Medicare. For fiscal year 1990 the error resulted from the Plan's failure to eliminate the interest factor from operational leases where the total lease payments were substantially in excess of the purchase price."

RESPONSE TO FINDING: BCBSF disagrees with this finding. The finding references FAR Section 31.205-36 as specifically disallowing interest expense associated with an operating lease. We find no language in this FAR that states this. Additionally, this FAR states Section 31.205-36 does not apply to ADPE and references FAR Section 31.205-2. FAR 31.205-36 part 1 does state rental costs under operating leases are allowable to the extent that the rates are reasonable at the time of the lease decision.

The decision to lease or purchase computer equipment (DASD Device) for CWF was analyzed by the Blue Cross Technical Services area. The analysis considered the present value of all related cash flows including monthly lease payments, tax considerations, and cash purchase price. The analysis showed the present value of the purchase to be \$890,373, excluding return on investment of \$56,000 for the first year versus the present value of lease payments to be \$822,890, resulting in a decision to lease.

This financial decision was not the only factor considered as part of this analysis although it certainly is important. The risk involved with a purchase of this magnitude and the dynamic nature of technology must also be considered in such a decision. Data



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processing equipment is constantly changing and may become obsolete. BCBSF was awarded a three year contract for CWF. Purchase of this EDP equipment would have locked CWF with the current technology and could have exposed the government (HCFA) to excessive financial loss due to the equipment becoming obsolete. Leasing the equipment provides for economical disposal in the event the contract is terminated and could provide for an economical upgrade of equipment based on need. Of the choices available to BCBSF in acquiring this equipment, we selected the one that was most advantageous to the Government.

All factors considered at the time indicate leasing as the best course of action.



Exhibit A

DEPARTMENT OF HEALTH & HUMAN SERVICES  
BUREAU OF PROGRAM OPERATIONS

Health Care Financing Administration

6325 Security Boulevard  
Baltimore, MD 21207

Refer to: BPO-P11

OCT 20 1988

Messrs. Rodgers, Rowan and Weinstein  
Milgrim Thomaian and Lee P.C.  
Suite 1000  
1025 Connecticut Avenue, N.W.  
Washington, D.C. 20036-5405

Gentlemen:

I am further responding to your letter of July 14, 1988, to Dr. William L. Roper, M.D., on behalf of your client, Management Data Communications Corporation. Please accept my apology for the delay in response.

The facilities management (FM) procurement referred to in your letter was conducted by our prime contractor, Blue Shield of Florida (BSF). It was not a government procurement, nor was BSF acting as a purchasing agent for the government. As such, the procurement is not subject to the statutory and regulatory requirements governing the Federal Government's direct procurements.

Medicare contractors are required by the terms of their contracts only to utilize competitive proposals to procure property and services to the maximum practical extent. Thus, while contractors must generally follow the Federal norm for conducting competitive acquisitions, strict adherence to Federal procurement rules and requirements is not mandated.

Your statement that the Health Care Financing Administration (HCFA) abdicated its responsibility to monitor the actual implementation of the RFP criteria is unfounded. HCFA exercised its proper role by reviewing BSF's evaluation of proposals for a claims processing system under a FM arrangement and its recommendation for the award of the subcontract. We found that the evaluation process was reasonable, in accordance with the evaluation plan, and not prejudicial to the interests of the government.

We also obtained the views of BSF with regard to the conduct of the procurement and received the contractor's assurance that the subcontract award was proper. We find no violation of the contractual agreement between BSF and HCFA and no evidence of manipulation of the evaluation or conflict of interest regarding the contract award.

— EXHIBIT — A

## Exhibit A

In sum, we have found that BSF's FM procurement was conducted on a competitive basis to the maximum practical extent as required by the terms of our contract. Given these facts, we believe a meeting with Dr. Ruper would not be advisable or productive.

Sincerely,

Barbara J. Gagel  
Director

cc:  
Blue Shield of Florida  
Associate Regional Administrator  
for Financial Operations, Atlanta



BRUCE A. DAVIDSON  
Vice President - General Counsel  
Corporate Secretary

552 Riverside Avenue P.O. Box 60729  
Jacksonville, FL 32236-0729  
(904) 791-6779  
(904) 791-6054 Telecopier

August 21, 1990

Ms. Barbara J. Gagel, Director  
Bureau of Program Operations  
Health Care Financing Administration  
6325 Security Boulevard  
Baltimore, Maryland 21207

Re: Blue Cross and Blue Shield of Florida, Inc. v.  
Mandat Computer Corporation and Michael L. Weinstein  
No. 88-790-CIV-J-16 (MD Fla. 1990)

Dear Ms. Gagel:

By this letter, Blue Cross and Blue Shield of Florida, Inc. (BCBSF) is requesting the Health Care Financing Administration (HCFA) to approve the settlement of the above-referenced judicial proceeding (the lawsuit), and thereby reimbursement for the administrative costs of: (1) the settlement amount paid by BCBSF, \$~~11,000,000~~; and (2) the legal fees incurred directly in connection with settlement negotiations and documentation.

The lawsuit arose out of BCBSF's activities as a Carrier pursuant to its Medicare B contract with HCFA (the Prime Contract). In 1987 and 1988 BCBSF, with HCFA's direction and approvals, conducted a Request for Proposals, Proposal Evaluation Process and Award for the data processing facilities manager subcontract for its Medicare B operations. The subcontract was awarded to GTE Data Services, Inc. (GTE). One of the three competing bidders, Mandat Computer Corporation (MDC), complained to HCFA and others that the award to GTE was improper, even though approved by HCFA. MDC and its then counsel Michael J. Weinstein wrote to Dr. William Roper and the Florida Times Union, making statements which BCBSF felt were defamatory.

The lawsuit was triggered by MDC's letter to BCBSF in September, 1988, demanding that \$11,000,000 be paid within twenty-one days to settle its alleged claim. After determining that MDC intended to bring suit if its demands were not met, BCBSF filed its defamation claim against MDC, adding claims against Weinstein for breach of fiduciary duty and negligence. With its answer thereto, MDC brought a counterclaim seeking to recover alleged lost profits in excess of \$20,000,000, bid preparation costs and punitive damages.

Ms. Barbara J. Gagel  
August 21, 1990  
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Since the lawsuit was begun in September, 1988, BCBSF has been engaged in responding to and demanding extensive documentary discovery. In June, 1990, BCBSF filed a Summary Judgment motion which addressed MDC's failure to exhaust administrative remedies and MDC's lack of a legal right to recover lost profits. During the period April through July, MDC deposed three third-party witnesses it claimed would prove the fraud alleged against BCBSF. The sworn testimony of these witnesses was inadequate to prove MDC's allegations of fraud. In light of this development and the pending Summary Judgment motion, MDC made a settlement demand which was substantially less than the damages claimed in its counterclaim. After several days of intensive discussions, the parties agreed to settle per the attached Settlement Agreement.

BCBSF elected not to precondition the settlement and settlement amount upon HCFA's prior approval. This determination was based upon two considerations: (1) BCBSF's counsel was certain that preconditioning settlement upon HCFA's approval would add 50% to 100% to MDC's demands; and (2) the September 10 discovery cut off for the October 1 trial date did not allow even a few days delay in the discovery process to await HCFA's decision, and immediate cessation of discovery and its expense was a major motivation for settlement.

Attorney Charles Ruff of Covington & Burling and I had the pleasure of meeting with Lloyd Weierman, Marilyn Koch, and Bernard Gelber last week to describe the events leading to the settlement. They noted that the provisions of Article XV of the Prime Contract requires prior written approval of a settlement as a precondition of reimbursement, but made it clear that they did not believe that BCBSF had acted improperly in pursuing the settlement. While the language of the Prime Contract supports a technical requirement for prior approval, BCBSF believes that the facts and circumstances surrounding this case warrant equitable treatment and that the settlement amount and costs attributable to it should be reimbursed for the following reasons:

1. The cost of completing preparations for and trying the lawsuit would have been at least 50% greater than the settlement amount. Thus, had BCBSF tried the case to conclusion with a favorable result (which is the very probable result) HCFA, with no right of prior approval, would have been obligated for reimbursement of a substantially greater amount than is now requested.

Ms. Barbara J. Gagel  
August 21, 1990  
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2. In the opinion of counsel negotiating the settlement, a precondition of HCFA approval would have added 50-100% to the settlement amount. Additionally, even a few days delay in obtaining HCFA's approval may have precluded settlement.
3. BCBSF required MDC to release HCFA as well as BCBSF without conditioning HCFA's release on HCFA reimbursing the settlement amount.
4. BCBSF's claim against Weinstein proved to have substantial value in the settlement negotiations and BCBSF released that claim and allowed its value to reduce the settlement amount without HCFA's reimbursement as a precondition.
5. The settlement amount is very favorable to BCBSF and HCFA under the circumstances. MDC began in September 1988 with an \$11,000,000 demand, claimed over \$20,000,000 in its counterclaim, and began settlement discussions in the \$3,000,000 range. Although BCBSF believes it would have ultimately prevailed, the expenses of going through a trial and possible appeal would have substantially exceeded the settlement amount.
6. Finally, and perhaps most important of all, the procurement which precipitated this lawsuit, and which introduced GTE as a facilities manager subcontractor for Medicare B, has been of enormous benefit to the Medicare program and HCFA. It was HCFA's influence in designing the RFP which allowed a firm such as GTE to compete against experienced firms like MDC and EDS. It was MDC's misconception of the reasons why the RFP and PEP were designed as they were which was largely responsible for the lawsuit. However, the reduction in cost per claim prices in this procurement, in later procurements and in existing contracts has and will save the Medicare program tens of millions in administrative expense. It would seem fair and equitable, therefore, that HCFA reimburse the settlement of this lawsuit which was a reasonably predictable by-product of such significant procurement effort.

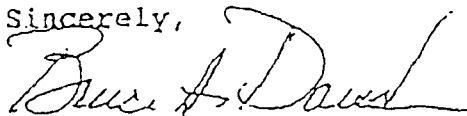
Exhibit B

Ms. Barbara J. Gagel  
August 21, 1990  
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Mr. Weinerman stated that he would probably discuss the issue of reimbursement with the OIG, which is investigating various aspects of the procurement, implementation and conversion. BCBSF understands this need, but we would note that this lawsuit concerned alleged pre-award fraud by BCBSF against MDC. We are unaware of any concern by OIG about BCBSF's pre-award conduct. We have heard, through various third parties, of OIG's concern about processing activities after conversion. BCBSF feels that these concerns are ill-founded but, in any event, they should have nothing whatsoever to do with the propriety of reimbursing the settlement costs of this lawsuit. We would appreciate the opportunity to participate in discussions with the OIG if there are any concerns in this regard.

BCBSF looks forward to favorable action on its request. If there is any further information or documentation which would be helpful to your decision, or if a further meeting with BCBSF would be helpful, we shall be pleased to respond.

Sincerely,



Bruce A. Davidson

BAD/tlh  
Attachment  
0721

cc: Lloyd Weinerman, Esquire

bcc: William E. Flaherty  
Michael Cascone, Jr.  
Antonio J. Pavino  
John M. McNatt, Jr., Esquire  
Charles F. C. Ruff, Esquire